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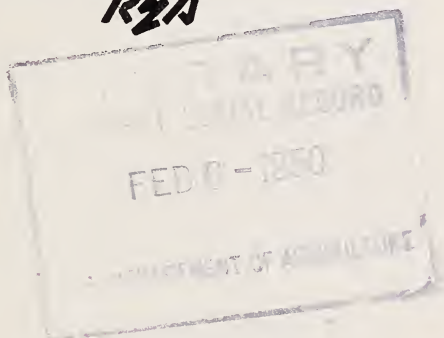
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The RURAL TELEPHONE LOAN PROGRAM

As provided by Public Law 423
81st Congress, amending
The Rural Electrification Act
of 1936

REA



**UNITED STATES
DEPARTMENT OF AGRICULTURE
Rural Electrification Administration
Washington, D. C.**

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This bulletin sets forth the basic provisions of the Rural Electrification Act relating to loans for rural telephone service, together with the principal standards and requirements that should be considered by prospective borrowers.

THE RURAL TELEPHONE LOAN PROGRAM

The Rural Electrification Act of 1936 was amended on October 28, 1949 to provide for the improvement and expansion of rural telephone service. In general, the aim is to furnish loans and technical assistance in the rural telephone field similar to that which has been provided for rural electrification.

Area Coverage

The basic policy established by the Congress for guiding the administration of the rural telephone loan program is set forth in the preamble to the telephone act, as follows:

. . . it is hereby declared to be the policy of the Congress that adequate telephone service be made generally available in rural areas through the improvement and expansion of existing telephone facilities and the construction and operation of such additional facilities as are required to assure the availability of adequate telephone service to the widest practicable number of rural users of such service (Public Law 423, 81st Cong.).

Telephone loan applications will be considered on the basis of whether they will result in providing adequate telephone service to the widest practicable number of rural subscribers. REA will endeavor to carry this policy into action in order that farmers and other rural people generally may enjoy efficient and economical telephone service.

Borrower Eligibility and Preference

To effectuate the telephone loan program, the act provides that:

. . . the Administrator is authorized and empowered to make loans to persons now providing or who may hereafter provide telephone service in rural areas and to cooperative, nonprofit, limited dividend, or mutual associations (Title II, Sec. 201).

The term "persons" includes "any natural person, firm, corporation, or as-

sociation" (Title I, Sec. 13). Loans will not be made to individual subscribers for the installation of their own station equipment.

Public agencies, municipalities or other governmental bodies are not eligible to participate in the rural telephone loan program, except that co-operative or mutual associations which may be technically designated as "public bodies" by State law are not thereby made ineligible.

The act also provides:

The Administrator, in making such loans, shall give preference to persons providing telephone service in rural areas, and to co-operative, nonprofit, limited dividend, or mutual associations: *And provided further*, That for a period of one year from and after the effective date of this title (October 28, 1949) applications for loans received by the Administrator from persons who on the effective date of this title are engaged in the operation of existing telephone service in rural areas shall be considered and acted upon before action is taken upon any application received from any other person for any loan to finance the furnishing or improvement of telephone service to substantially the same subscribers (Title II, Sec. 201).

The Report of the House and Senate conferees on the telephone legislation (H. Rep. No. 1450) specifically states, "As amended by the committee of conference, this preference sentence provides that for a period of 1 year after the effective date of the legislation, when two or more applications are received covering telephone service to substantially the same subscribers, the application, if any, from the person then engaged in providing the telephone service to those subscribers shall be considered and acted upon before action is taken upon any other application covering substantially the same subscribers. . . . The provision agreed to by the committee of conference extends the preference period to 1 year and requires that during that

time the Administrator must take action upon the applications of existing companies before he can consider any conflicting applications."

Thus, loans may be made to a new organization before October 28, 1950, only if:

1. No existing company engaged in serving rural areas has made application to serve substantially the same subscribers; or

2. An application for a loan from an existing company to serve substantially the same subscribers has been considered and found not to comply with the requirements of the act.

Purpose of Loans

Loans may be made "for the purpose of financing the improvement, expansion, construction, acquisition, and operation of telephone lines, facilities or systems to furnish and improve telephone service in rural areas." (Title II, Sec. 201.)

Section 201 of the Act requires that:

The Administrator in making such loans shall, insofar as possible, obtain assurance that the telephone service to be furnished or improved thereby will be made available to the widest practical number of rural users.

Loans may be made for:

. . . refinancing outstanding indebtedness of persons furnishing telephone service in rural areas; *Provided*, That such refinancing shall be determined by the Administrator to be necessary in order to furnish and improve telephone service in rural areas: *And provided further*, That such refinancing shall constitute not more than 40 per centum of any loan made . . . (Title II, Sec. 201).

Rural telephone loans will not be made for refinancing existing indebtedness merely to enable borrowers to obtain a lower rate of interest or a longer amortization period. Such loans will be made only when necessary to improve or extend service in rural areas.

Loans will not be made merely for the purpose of effecting the consolidation of telephone organizations. A telephone system resulting from a merger or consolidation, however, may obtain loans for the improvement and extension of rural telephone service in the combined areas. "It is not the intention" of the Congress, as indicated explicitly by the Report of the House and Senate conferees on the telephone legislation (H. Rep. No. 1450) "to prohibit a number of existing rural telephone companies, systems, or lines from combining voluntarily, forming a new company or association, and receiving a loan for the improvement of telephone service in their combined areas."

The authority to finance acquisitions, as used in Title II, Sec. 201 (quoted above), includes "authority for loans for the purpose of the acquisition of one company by another or of lines or facilities, where such acquisition is merely incidental to the main purpose which must be the improvement or extension of rural telephone service" (H. Rep. No. 1450).

Definition of Rural Area

As already stated, the purpose of the rural telephone act is the improvement and extension of telephone service in rural areas. The act provides that:

. . . the term rural area shall be deemed to mean any area of the United States not included within the boundaries of any incorporated or unincorporated city, village, or borough having a population in excess of one thousand five hundred inhabitants (Title II, Sec. 203 (b)).

However, the act provides further that "When it is determined by the Administrator to be necessary in order to furnish or improve telephone service in rural areas, such loans may be made for the improvement, expansion, construction, acquisition and operation of

telephone lines, facilities, or systems without regard to their geographical location.” (Title II, Sec. 201.) This provision permits the Administrator to make loans for telephone facilities that are located within cities, villages or boroughs of more than 1500 inhabitants, if such facilities are necessary to the provision of adequate telephone service outside the boundaries of such places.

Definition of Telephone Service

. . . the term “telephone service” shall be deemed to mean any communication service whereby voice communication through the use of electricity between the transmitting and receiving apparatus, is the principal intended use thereof, and shall include all telephone lines, facilities, or systems used in the rendition of such service . . . (Title II, Sec. 203 (a)).

Thus, telephone service includes voice communication by conventional wire circuits, or carrier circuits over either telephone or electric service lines, and radio telephony.

Loan Terms

Title I, Section 4 of the Act provides that “all such loans shall be self-liquidating within a period of not to exceed thirty-five years, and shall bear interest at the rate of 2 per centum per annum.” The self-liquidating requirement means that there must be sufficient revenues from the borrower’s system, in excess of operating expenditures (including maintenance and replacement), to repay the loan.

The actual loan period for any particular loan may be less than the maximum authorized period of 35 years, depending on the circumstances of each individual case. Funds will not be advanced until needed by the borrower to meet approved obligations. While interest will be charged from the date funds are advanced, payment of principal and interest may be scheduled to

begin after the construction or development period, if deemed advisable by REA. Such scheduling, however, will not add to the length of the loan period initially agreed upon.

Security Requirements

Loans under this section shall not be made unless the Administrator finds and certifies that in his judgment the security therefor is reasonably adequate and such loan will be repaid within the time agreed . . . (Title II, Sec. 201).

The making of loans for financing the improvement and extension of rural telephone service involves financial hazards such as (1) the possibility of subscribers giving up service when economic conditions are unfavorable, (2) sleet and storm damage, and (3) the relatively low level of earnings of rural telephone systems under average conditions. Because of these hazards, each borrower will be required to provide equity to supplement the amount of the loan. Among the factors which will be taken into consideration in determining the amount of equity to be required in particular instances are the following:

1. The condition and value of the physical telephone properties offered as security for repayment of the loan.
2. The system revenues, present and prospective, available for repayment of the loan with interest, as scheduled.
3. The size, character and operating efficiency of the system.
4. The extent to which widespread community interest, as represented in the ownership, management and patronage of the telephone enterprise, tends to assure continuity of (a) subscriber use of the service, and (b) efficient management and control.

5. The extent to which the net worth of the borrower may increase during the life of the loan.
6. The extent to which REA guidance and assistance in management and operating practices will tend to assure efficient system operation and maintenance of adequate telephone service.

Depending on the extent to which these factors are present in each case, the borrower will be required to provide equity, supplementing the loan, amounting to 10 to 50 percent of the total value of the borrower's system, including the facilities financed by the REA loan. In some cases even more than 50 percent equity may be necessary.

In all cases where applicants are subject to the jurisdiction of State regulatory bodies with respect to financing the requirements of the State regulatory bodies must be met.

Loan Document Provisions

In order to assure continued adequacy of the security and the quality of telephone service over the life of the loan, suitable provisions will be included in the loan documents. Certain standard provisions will be applied generally to all borrowers, including the following:

1. *Mortgage Requirements.*—Normally, a first mortgage will be required on the borrower's entire system. In the case of loans to finance telephone facilities which do not in and of themselves constitute self-contained operating systems or units, it will be necessary for the borrower, in addition to the mortgage, to furnish adequate assurance, in the form of contractual and other security arrangements, that continuous and efficient telephone service will be rendered.

2. *Area Coverage.*—Borrowers will agree to accomplish area coverage telephone service by making service available to all applicants for service within their rural service areas, as rapidly as practicable.
3. *Advance and Use of Loan Funds.*—Borrowers will use loan funds only for the purposes agreed upon. Loan funds will be advanced to borrowers only as needed to meet approved obligations. Interest will be charged from the time when funds are actually advanced.
4. *Construction Standards.*—Borrowers will agree to follow construction standards acceptable to REA; to expend loan funds for equipment and materials of acceptable quality; and to make arrangements for engineering services acceptable to REA. REA will retain the right to inspect construction for compliance by the borrower with its obligation under the loan documents.
5. *Audits, Financial and Operating Statements.*—Borrowers will agree to maintain a system of accounts satisfactory to REA and subject to REA inspection; and to submit specified financial and operating reports periodically, as long as any portion of the loan remains outstanding. Borrowers will also agree to periodic audits of their records by REA or by certified public accountants.
6. *Sales, Salaries, Dividends, Service and Operating Contracts and Arrangements.*—Borrowers will agree not to sell or otherwise dispose of facilities or equipment financed with loan funds or furnished as security, except with REA approval or until the loans are fully repaid. As long as any portion

of a loan remains outstanding, REA reserves the right to pass upon the reasonableness of all expenditures, and contracts and arrangements affecting security, such as salaries, dividends, service and operating contracts and arrangements.

7. *Maintenance and Operation*.—Borrowers will agree to maintain their systems in good repair, working order and condition; to make necessary replacements and alterations; and to provide adequate telephone service.
8. *Insurance*.—Borrowers will agree to take out and maintain adequate insurance and fidelity coverage, as long as any portion of the loan remains outstanding.
9. *Rates, Charges and Reserves*.—Borrowers will, subject to applicable laws and rules and orders of regulatory bodies, establish rates and charges which will yield sufficient revenue to cover all operating and maintenance expenses, including replacement, taxes and insurance, and all payments of principal and interest on the loan. Such rates and charges shall also be consistent with the achievement of the basic purpose of the telephone legislation, namely, "to assure the availability of adequate telephone service to the widest practicable number of rural users." Borrowers will be required to establish and maintain proper reserves for operating expenditures, replacements, payments on loans and other purposes as specified by REA.
10. *State Regulation*.—In accordance with Section 202 of the Act, borrowers will agree to comply with applicable State laws and the re-

quirements of State commissions, boards or other bodies having jurisdiction over them.

In addition to the foregoing standard provisions which are generally applicable to all borrowers, provisions such as the following may also be made a part of the loan documents, depending upon the security situation in each case, including the factors listed under the heading "Security Requirements":

1. Approval by REA of the borrower's managerial personnel.
2. Removal and replacement of managerial personnel, when, in the opinion of REA, the Government security requires it.
3. REA approval of agreements between the borrower and third parties relating to construction or operation of the system, such as agreements pertaining to switching service, toll service, acquisition of existing facilities, purchase of land, materials, supplies and equipment.
4. Agreement to keep any property constructed, purchased or acquired free from any liens or encumbrances other than the REA mortgage.
5. Approval by REA of the construction of any additions, extensions or improvements to the borrower's system.
6. Agreement to incur indebtedness in addition to the REA loan only with REA's consent.
7. Adherence to accepted operating and maintenance procedures and practices, personnel training programs, office procedures, and equipment maintenance programs.
8. Transmission promptly to REA of certified copies of the minutes of all meetings of members and of directors.

9. In the case of cooperative, nonprofit, limited dividend and mutual association borrowers, agreement not to pay salaries to directors. Directors' fees and expenses will be subject to REA approval.
10. As a means of safeguarding the Government loan through a broad base of subscriber ownership and control, agreement by cooperative, nonprofit, limited dividend and mutual associations to:
 - (a) Establish voting on the principle of "one member—one vote."
 - (b) Make membership available to all subscribers upon receipt of membership fee.
 - (c) Credit to subscribers in proportion to patronage all payments for service in excess of cost, other than payments provided for in (d).
 - (d) Declare or pay no dividends, except that dividends not exceeding 4 percent per annum may be paid on capital furnished as equity in connection with the loan.
11. In the case of a cooperative, nonprofit, limited dividend or mutual association borrower, agreement that REA shall have the right to appoint a supervisor to assume temporary management when found necessary by REA to protect the Government security and the members' interests and to achieve the objectives for which the loan was made.

Duplication of Facilities

Loans shall not be made "in any State which now has or may hereafter have a State regulatory body having authority to regulate telephone service and to re-

quire certificates of convenience and necessity to the applicant unless such certificate from such agency is first obtained." (Title II, Sec. 201.) It will be the responsibility of the applicant to obtain from the State authority, where necessary, the required certificates of convenience and necessity or franchises, approval to borrow, and approval of rate schedules.

"In a State where there is no such agency or regulatory body legally authorized to issue such certificates to the applicant, no loan shall be made under this section unless the Administrator shall determine (and set forth his reasons therefor in writing) that no duplication of lines, facilities, or systems providing reasonably adequate services will result therefrom." (Title II, Sec. 201.) In such cases, applicants will be required to supply the necessary information.

Where to Apply for Loans

All applications should be made directly to the Rural Electrification Administration, United States Department of Agriculture, Washington 25, D. C. It will be unnecessary and undesirable to retain the services of any agents or representatives, either in Washington or locally, to assist in obtaining a loan. No part of any loan secured from REA may be used in payment for such services. This does not mean that applicants should not accept the assistance of farm organizations, local Extension Service leaders, cooperative and other organizations and associations interested in advancing the program. REA will advise applicants of any financial or engineering services that may be required.

Applications

Applications furnishing preliminary information in connection with pro-

posed loans will be accepted on forms provided by REA. After the information is examined, the applicant will be notified of any further steps to be taken. Applicants are advised not to incur expenditures for audits, incorporation, appraisals, or the assembly of other information until advised to do so by REA.

Application forms and copies of the Rural Electrification Act are available on request.

